

Mending a mangled Malaysia Airlines

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 alaysia Airlines is a disaster that has already happened — twice over. It is at the most critical state of its development and if drastic action is not taken soon, we may have a chronically crippled airline.

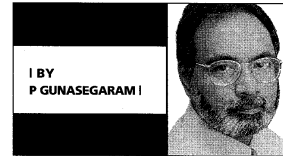
Before we go any further, let's get three

things absolutely clear about Malaysia Airlines.

First, it never turned around after the government took back control from Tan Sri Tajudin Ramli at twice the market price in 2001. It reported profits only because the government assumed direct ownership of its planes, reducing the airline's financing costs, and took over the losses at domestic opera-

tions. Its latest loss simply means it has sunk much deeper into the red.

Second, the way its financial accounts have been reported and the absolute opacity of the results of its holding company, Penerbangan Malaysia Bhd, makes it impossible to precisely say how badly the airline is doing, although it's possible to make an educated guess.



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Third, there are very serious, wide-ranging operational difficulties at the airline and it looks like even basic things like controlling costs by hedging fuel prices have not been adhered to by the board and management.

Just how serious are problems at Malaysia Airlines, and the company which operates it, Malaysian Airline System or MAS? Very, very serious. Here's why.

For the quarter to June 30 this year, the first of three quarters for its shortened financial year which is being switched to December from March, it made a massive net loss of just over RM280 million compared to a profit of just over RM26 million for the previous corresponding period. That's a downturn of over RM300 million.

If that kind of bleeding is not reversed, the potential yearly loss could be over RM1 billion, exceeding even the net loss of RM836 million for the year ended March, 2002, among the largest losses, if not the largest, ever recorded by the airline.

Effectively, such a large loss will be worse than any other MAS has incurred because of the widespread asset unbundling (WAU) scheme of 2002 which made MAS quite a different animal from what it was before that and turned it around to instant profitability.

That was done by transferring ownership and cost of aircraft to a government company, Penerbangan Malaysia Bhd (PMB), fully owned by Khazanah Nasional Bhd and which is now MAS' holding company. PMB also assumed all losses from domestic operations.

Just how much is the cost of the juggling of assets to PMB and, therefore, the gain to MAS from this government rescue? We can't tell for sure because the government does not disclose PMB's losses and MAS does not disclose domestic losses anymore. But we can sort of deduce it from the detailed annual accounts, but not from the quarterly accounts.

This is what we wrote in August 2002 in response to the WAU scheme and we reproduce this because it remains true to this day: "As elegant and simple as the financial re-engineering scheme (WAU) of Malaysian Airline System Bhd is, the airline will not turn around next year (2003) as most people expect it.

"What will turn around to profit is the operator of the current airline's assets — quite a different animal from the current airline, for the new Malaysia Airlines' assets will effectively be vested with government-owned companies, removing the cost of ownership from Malaysia Airlines.

"What then is the true test of turnaround? True turnaround will happen only when the new Malaysia Airlines and all the government vehicles which own its assets, taken together, show profits."

It is a sad reflection on both the government and its investment arm Khazanah Nasional that disclosure is insufficient to enable a public and open analysis of these very important bits of information.

This is also why if the current MAS makes a loss, it indicates that if it was the previous MAS, it would have made a much bigger loss. In the MAS circular in relation to WAU dated October 2002, it was stated

CONTINUES ON PAGE 26

Serious operational problems

FROM PAGE 10

that MAS would make a net profit of RM95 million for the year ended March 31, 2003, if WAU was in place, otherwise it would make a loss of RM505 million.

That meant that WAU would effectively transfer losses of RM600 million (505 + 95) to PMB by transferring the cost of ownership of aircraft and losses from domestic operations to PMB.

If this trend remained, MAS would have to make a net profit of over RM600 million before it can logically claim to have broken even. The closest it came was for the year ended March 31, 2004, when net profit was RM461 million, still short of RM139 million.

If we allocate that RM600 million over four quarters, MAS' latest quarterly loss will balloon by a further RM150 million to RM430 million. Here is the biggest indict-

ment against WAU: *It masks serious operational problems at MAS.*

Therefore it may, on hindsight, be better not to have had WAU at all and to have rescued MAS through a direct injection of capital into MAS by the government and allowed it to operate like all other airlines in the world, instead of leasing back aircraft on favourable terms from its government-owned major shareholder.

Here's more. MAS chairman Datuk Dr Munir Majid is absolutely right when he said that the company has not been making operating profits even after WAU. "The profits that have been made are an accounting profit, attributable to gains from one-off benefits, not from sustainable operational performance."

A check of the annual accounts shows that he is right. Losses would have been incurred if exceptional items and other income not related to the running of an airline are taken out.

The very serious conclusion from this: *MAS had never turned around operationally, despite the transfer of a heavy balance sheet and of losses of domestic operations to the parent.*

The severe losses for the latest quarter arise from a steep 28% increase in costs to RM3.13 billion while revenue increased 16% to RM2.77 billion. Of this, fuel costs rose almost 60% to RM1.1 billion while other costs rose 17% to RM2 billion. Other income of RM72 million mitigated the losses.

A runaway increase in costs is MAS' main problem and indications are that it did not hedge or insufficiently hedged its fuel exposure in the face of rising oil prices. Whether that meant that management was taking a position that fuel prices would come down cannot be answered because there is no information forthcoming.

This kind of a loss at a time when many leading airlines, which had no WAU to unbundle their assets and transfer loss-making operations, were still making good, albeit lower profits, is totally unacceptable.

That a major revamp of MAS is needed is unquestioned and those who debate about whether a Malay, non-Malay Malaysian or foreigner should head the airline simply do not appreciate the gravity of the situation.

Anyone who has a proven track record of excellent performance and can do the job should be a candidate. And that candidate should bring in a team eventually which will cover every area of operations and build expertise from the bottom upwards. Importantly, that candidate must be empowered and given the mandate to do what it takes to turn the airline around.

For the year ended March 31, 2005, the Emirates Group, which operates the highly successful Emirates airline, which has won over 200 international awards, made a net profit of US\$708 million (RM2.7 billion), its 17th consecutive year of profit. The group president is one Maurice Flanagan, CBE, and the president of the airline is one Tim Clark. The chairman is Sheikh Ahmed Saeed Al-Maktoum.

Smart ownership means getting the best from home and abroad to run your business and to recognise that if you want to be global, you must recruit the best globally and learn from them until you become just as good or better.

Otherwise, what chance do you have to compete globally?

We can do it too and we must do it well. Munir talks about RM1 billion in five years. That's too modest a target. Why? Because the MAS of old, when it had the burden of aircraft ownership and domestic operations, made a net profit of RM333 million for the year ended March 31, 1996.

Now, add that RM600 million we talked about to make it comparable to the current MAS, and it was already making close to RM1 billion net nine years ago. So, RM1 billion five years from now or 14 years after it made a similar amount seems way too little, don't you think?

Just goes to show to what depths MAS has sunk. ■